

DOD Competitive Sourcing: Analysis and Recommendations for Reform

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Subject Area - DOD

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Executive Summary

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Title: *DOD COMPETITIVE SOURCING: Analysis and Recommendations for Reform.*

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Thesis: DOD can leverage the commercial sourcing process (outsourcing and privatization) as a tool to improve quality, reduce resource requirements, and focus management on core tasks. To successfully implement these programs, DOD must first improve its internal systems and processes.

Discussion: DOD managers are faced with two major dilemmas. First, budget authority will not support all readiness, investment, and modernization requirements. Second, internal and external stakeholders will no longer tolerate comparative inefficiencies noted between DOD and the private sector. In response, Defense managers are increasingly viewing competitive sourcing as a tool to meet these demands. Post Cold-War downsizing led to a disproportionate reduction of operational forces (tooth), as compared to infrastructure (tail), thus leaving the Defense infrastructure ripe for reform. Competitive sourcing is one tool to effect this reform.

Private industry has proved that competitive sourcing can reduce costs, improve quality, focus management and resources on core functions, and share risks with suppliers.

While there are great internal and external pressures moving DOD toward competitive sourcing, many strong impediments and risks remain. Most of these are legal and regulatory in nature, and marked by intense stakeholder passion.

Conclusion/Recommendations: If judiciously and effectively employed, DOD can reap great benefits from outsourcing and privatization. DOD must first, however, reform management of the competitive sourcing decision making and execution processes. The first step should be establishment of a centralized commercial sourcing office at both DOD and Service-levels. These offices should have the authority and resources to champion the sourcing process and facilitate planning and execution.

As a precursor to effective competition, DOD should reform the infrastructure's commercial activities by accomplishing the Revolution in Business Affairs (RBA) as directed in the Defense Reform Initiative (DRI). Managers must be given the tools and resources needed to effect reengineering and create first-class organizations. Only through executing the RBA will Defense managers be able to properly compete their activities with the private sector, and make an educated decision of best-value to the government. One of the key reforms needed is the development of cross-functional managerial costing systems.

To maximize the benefits of commercial sourcing and operate within restraints, Defense managers can become more entrepreneurial and capitalize on the use of long-term defense/industry partnerships. These integrated relationships should be performance-based and share both risks and rewards. Contractors can no longer be held at arms-length - they must have the security to invest in personnel and assets which will maximize the partnership and provide optimum value.

To overcome internal impediments to change and dysfunctional organizational behavior, Defense managers should review and better align personnel reward systems with organizational goals. These changes will require civil service reform. DOD must also provide better funding for sourcing studies and initiatives to remove the disincentives which now deter manager initiative.

Section I : Introduction

This paper analyzes competitive sourcing of commercial activities within the Department of Defense (DOD). The purpose of the paper is to inform the reader of DOD's goals and experiences with commercial sourcing, and provide recommendations for improvement of the decision making and execution processes. The author intends to provide a comprehensive study, aimed at the DOD manager, that brings together theory, practice and the operational environment.

To provide background, the paper will begin with a discussion of the historical developments which led DOD toward commercial sourcing. The study will then define competitive sourcing, outline the main types of sourcing, and analyze the current processes for decision making and execution. Next, the operational environment will be reviewed. The study will analyze environmental factors promoting competitive sourcing, and the unique challenges and opportunities confronting DOD. This paper will then review select political, social, economic, managerial and financial theories to provide context for analysis. After this context is established, the author will analyze DOD's goals, experiences, and management of the commercial sourcing process. After this analysis, the author will address key issues which limit DOD's commercial sourcing flexibility, and certain risks which should be analyzed in the decision making process. The paper will conclude with final recommendations and thoughts for DOD in its implementation of outsourcing efforts. The majority of the author's analysis and recommendations, however, will be interwoven throughout the study.

Section II: History of Military Commercial Sourcing

Military outsourcing and privatization (O&P) are as old as warfare itself. A walk through the Pentagon halls may lead a casual observer to mistakenly believe it is a contemporary management technique along the lines of Total Quality Management (TQM), Business Process Reengineering (BPR), or other mantras of the '80s and '90s. Throughout history, rulers relied not only on private sector support for their armies, but often contracted entire mercenary armies. Napoleon extensively utilized mercenary troops to support his *Grande Arme'e*.¹ In 1815, the United Kingdom utilized a force of 150,000 soldiers and support personnel contracted from the East India Company to provide the colonization force for India.² The impressive mobilization of the United States for World War I, and later in the century for World War II, was borne largely on the back of the United States' private sector and its grand industrial capacity.³ Private sea and air transportation assets have always been critical to U.S. military logistics and force-projection capabilities, and remain so today. 95% of all military equipment deployed to the Gulf War were transported by Military Sealift Command,⁴ which is largely composed of commercial shipping vessels.

¹ Of the 600,000 in the year 1811 French Army, only 270,000 were French Soldiers. Kennedy, Paul A. *The Rise and Fall of the Great Powers*. Random House, New York, 1987. 136.

² Shearer, David. "Outsourcing War." *Foreign Policy*. Fall 1998, 68.

³ The United States led the world powers in measures of relative industrial power, per capita industrialization, national income, and manufacturing output from 1914 to 1938. Kennedy. *The Rise and Fall of the Great Powers*. 201-203, 242-243, 330-333.

⁴ Pagonis, Gust W. *Optimizing Strategic Sealift*. Naval Post Graduate School. 1995. 1.

It wasn't until the end of World War II that the U.S. Armed Services developed and maintained large standing forces and internal infrastructures. Learning from the problems of Wilsonianism and post WWI isolationism, and prompted by the oncoming Cold War, the United States developed large standing forces and bureaucracies for the first time. Many of these Cold-War organizations, although inefficient, remain today in various forms.

The private sector maintained a similar pattern. Arising from WWII as the only large industrial power still in-tact, U.S. businesses dominated international markets. This dominance was fueled by the advent of the Bretton Woods Systems, and the United States supremacy in the corresponding expansion of international trade. With these advantages, U.S. businesses created behemoth international monopolies and oligopolies, and created extensive bureaucracies to manage these unprecedented, large organizations. It wasn't until the '70s that foreign corporations were able to significantly challenge United States dominance. Late to recognize these threats, U.S. businesses were forced into crisis action. In the '80s and '90s the acronyms of TQM and BPR, and the theories of W. Edwards Deming and other reform proponents became commonplace. Corporations were forced for the first time to specialize, shed resource-absorbing infrastructure, focus on their core competencies, and liquidate secondary interests. One result was a wave of outsourcing efforts, modeling the competitive advantage gained by Japan through "industrial sourcing."⁵

⁵ For a complete discussion of the United States' foreign competition challenges - and responses to foreign business threats in the 1970-1990 period, see Prestowitz, Clyde V. *Trading Places*. Prestowitz, New York. 1988. Chapter 1: "The End of the American Century."

A 1996 survey shows outsourcing had grown to a \$100 billion business, represented by the following statistics:⁶

- 77 percent of Fortune 500 companies outsource some major aspect of their support services.
- 50 percent of 1200 firms surveyed with information technology expenses over \$5 million currently are, or are in the process of outsourcing that function.
- 48 percent of 309 Fortune 1000 firms surveyed outsource their warehousing functions.
- 45 percent of 400 large firms surveyed outsource their payroll function.

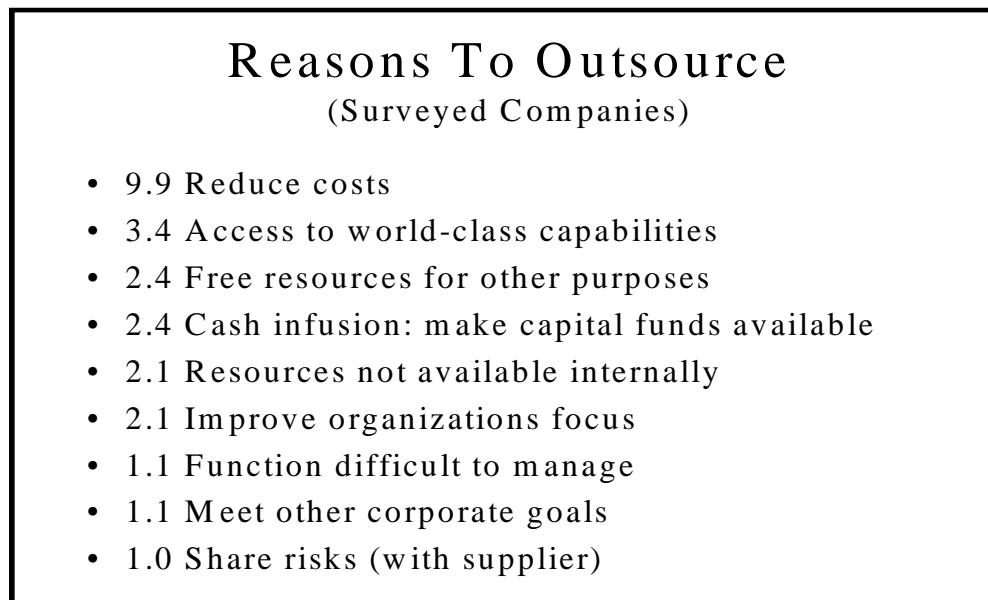
Figure 1, below, shows the results of a 1997 survey of private corporations by the Center for Naval Analysis (CNA).⁷ The corporations were asked to rate their reasons for outsourcing, with a score of 10 being the highest. It is important to note that, although reducing costs is the most prevalent response, these corporations utilize outsourcing for various goals.

⁶ Privatization Integrated Policy Team, Office of the Deputy Secretary of Defense, Information Paper. *Improving the Combat Edge Through Outsourcing*. March 1996, 6.

⁷ DiTrapani, Anthony R. *Rightsourcing Lessons Learned*. Center for Naval Analyses Study. May 1997, 20.

Not all private sector outsourcing, however, has been successful. One area of disappointment is information technology (IT). Deloitte and Touche Corporation conducted a survey of 1,500 Chief Information Officers who had outsourced IT functions. 69 percent of those surveyed indicated they were disappointed in their long range outsourcing results, and failed to achieve expected cost savings.⁸

Figure 1



DOD remained largely sheltered from the competitive forces facing private industry until the end of the Cold War. With real-dollar budget decrements, and resulting crises in modernization funding, DOD had to look inward to find efficiencies and resources. Also fueling the impetus for reform were examples of successes in the private sector - and the resulting demand from Congress, the Executive, and the American people for greater accountability and similar efficiency in DOD. DOD must now benchmark its commercial activities against the

⁸ Washington, William. "Subcontracting as a Solution, not a Problem in Outsourcing." *Acquisition Review Quarterly*. Winter 1999, 80.

private sector, improve to that standard, or analyze outsourcing or privatizing that function.

Figure 2, taken from the November 1997 Defense Science Board (DSB) report, shows the benchmark in selected logistics standards, as an example, between DOD and companies with efficient world-wide distribution systems.⁹ Differences of this magnitude have become unacceptable to external DOD stakeholders.

Figure 2.

<u>Process</u>	<u>DOD</u>	<u>Commercial Companies</u>		
Distribution	24 Days Avg.	1 Day (Caterpillar)	3 Days (Motorolla)	2 Days (Boeing)
Repair Cycle Time	18-25 Days (Air Force)	14 Days (Detroit Diesel)	14 Days (Boeing)	3 Days (Compaq)
Procurement	88 Days	4 Days (Texas Inst.)	0.5 Days (Portland Gen.)	Minutes (Boeing)

Section III: Competitive Sourcing - Definition, Types, and Processes

Definition and Types of Competitive Sourcing

Competitive sourcing is the comparative process used to analyze DOD commercial activities against those offered in the private sector, ultimately selecting the provider of greatest

⁹ Office of the Under Secretary of Defense (Acquisition and Technology). Defense Science Board Task Force Report. *Achieving an Innovative Support Structure for 21st Century Military Superiority*. Washington DC: GPO, November 1996.

value to the government. Greatest value extends beyond cost - it is also a function of quality, reliability, responsiveness and other performance criteria as set by DOD leaders.

If private sector performance of the activity is chosen, DOD will outsource or privatize the activity. In their simple form, outsourcing and privatization (O&P) are defined as the transfer of work previously done by DOD employees to the private sector. In practice, many forms and derivatives are available. The more common forms are defined below:

- * *Contractor Owned-Contractor Operated (COCO)*. In this form of outsourcing, the contractor provides all assets, labor, supplies, and other requirements. This is the most common and straight-forward method, often done under A-76 procedures (later defined).

- * *Government Owned-Contractor Operated (GOCO)*. Work is contracted to a civilian provider who performs the work utilizing completely or partially government owned facilities and assets, e.g., operating a base power plant. This is a form of outsourcing versus privatization as government assets are not transferred.

- * *Privatization*. Privatization, by definition, includes the sale or transfer of government assets to a contractor. An example is the sale of government housing units to a private contractor, who would then maintain and provide the housing to soldiers under contract. This differs from GOCO in that asset ownership transfers to the contractor. In some privatization relationships, the government may maintain an overseer or regulatory function, such as with Fannie Mae, or the Federal Reserve Banks.

* *Inter-Service Support Agreements (ISSA)*. ISSAs contract for goods, services, use of excess property, or common services from other Military Services or Federal Agencies. ISSAs are governed under the Federal Property and Administrative Services Act, The Economy Act of 1932, and the Government Reform Act of 1994.¹⁰

* *Partnering relationships*. These relationships include forms of government/industry teaming projects, facility use agreements, and other joint ventures. These relationships are gaining increased focus as they share risk and resources and provide flexible selection of capital and labor mix. Partnering is normally conducted under Limited Liability Partnership (LLP) or Limited Liability Corporation (LLC) legal structures, or another form allowed under the Federal Acquisition Regulation (FAR) and Defense Department equivalent (DFAR). Partnering will be discussed later in more detail.

The A-76 Circular Process

Circular No. A-76, *Performance of Commercial Activities*, issued by the Office of Management and Budget (OMB), establishes Federal policy for the competition of government commercial activities. The circular defines a commercial activity as the process, resulting in a product or service that is, or could be obtained, from a private sector source. All commercial activities, unless otherwise exempt, are required to compete with the private sector. Circular A-76 specifies all requirements for the conduct of the competition to include the costing methods to be used, procedures for analysis, and criteria for selection.

¹⁰ Office of Management and Budget (OMB), Circular No. A-76. *Performance of Commercial Activities*. Washington DC: GPO, March 1996, 8.

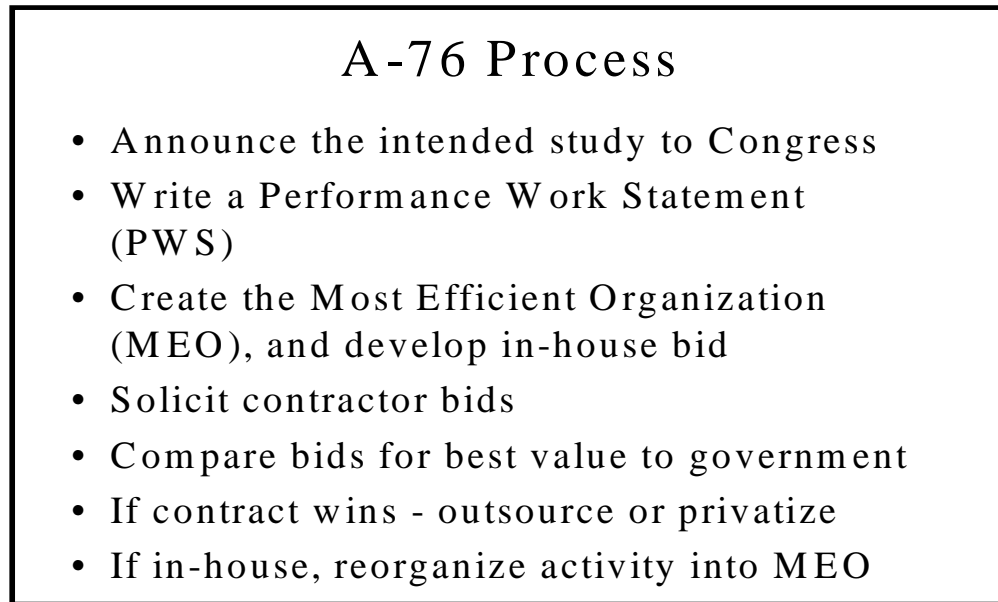
Functions defined as inherently governmental are exempt from the requirements of A-76. Parameters for this classification are outlined in Office of Federal Procurement Policy (OFPP) Policy Letter 92-1 as those activities, “[T]hat are so intimately related to the exercise of public interest as to mandate performance by Federal employees.”¹¹ Appendix D of this report contains Exhibit 1 from Circular A-76, outlining the detailed conditions permitting government or contract performance of commercial activities. Most exempted positions fall under one of the following categories:

- * Combat functions and the command of combat activities.
- * Management, oversight, or the commitment of government expenditures.
- * Control, direction, hiring, or selection of government employees.

The major steps required in an A-76 competition are shown in Figure 3. This is a very rudimentary summary. The individual tasks are quite complex and resource intensive. The average A-76 study takes approximately two years, with competitions for large contracts taking up to 5-8 years. A large competition can cost \$500 thousand or more. For a more complete treatment, a detailed explanation of the A-76 tasks is provided in Appendix C.

¹¹ OMB, *Circular A-76*, 3.

Figure 3



After notifying Congress, the Service must write a Performance Work Statement (PWS) to define the commercial activity's tasks, workload, levels of service and performance required, and the availability of government assets (if any) in execution of the tasks. The PWS also states the contractual arrangement to be used, to include any use of government assets or other support. The activity will then reengineer itself into what it determines is the Most Efficient Organization (MEO) to perform that PWS. The in-house activity will then develop a cost estimate to perform the PWS, utilizing the cost sheet shown at Appendix E. The PWS is then announced for solicitation of contractor bids, which will be compared to the in-house bid for contract award. If a contractor wins the bid, the Service will execute the form of outsourcing or privatization specified in the PWS. If the in-house activity wins, it is required to reform into the envisioned MEO. The activity cannot be reopened to competition for another five years.

Chapter 5 of Circular A-76 provides for a streamlined cost comparison procedure if the activity includes less than 65 full time employees, and the government (Service) determines that the simplified comparison will serve the equity and fairness intent of the Circular. This streamlined version primarily removes the requirement for a new PWS and development of the MEO. The process bases the government (in-house) costs on the current organization and its historic costs. The streamlined CCF is shown at Appendix F.

Alternatives to A-76

There are alternative processes to the A-76 allowed under OMB guidelines. Unless otherwise specifically prohibited by law, or if the activity is an inherently governmental function, DOD can directly convert an activity to contract under the following criteria:

- * The activity has fewer than 10 Full Time Employees (FTE). (A-76 sets the competition requirement at 45 FTEs, but the 1997 Appropriation Act reduced that threshold to 10).
- * It is a new requirement - never conducted in-house to begin with.
- * DOD eliminates the function through reengineering, or agrees to no longer perform that function. For example, when DLA contracted for vendor delivery of pharmaceuticals, it was able to eliminate excess warehouse activities.
- * Another DOD component is currently performing the function for the service. (This provision does not apply to services provided by another Federal department or agency - which still require A-76).

* The activity is a military function (non-inherently governmental). An example would be an installation armament maintenance shop currently run by soldiers.

* A waiver is gained from OMB for a justified cause. The waiver process still requires a cost comparison, but is much more streamlined than A-76.

Section III: The Environment; Guidance, Challenges, and Opportunities

Factors Promoting Competitive Sourcing

There are numerous factors that support the need for DOD to improve internal business practices and develop an effective mix of in-house performance and commercial sourcing:

- The Defense budget is likely to stabilize or continue to decline in real dollars.
- Current modernization expenditures are inadequate.
- Further reductions in operational force structure are risky to the National Military Strategy.
- Congress is unlikely to permit further base closures in the near-term.

Defense funding is likely to remain around \$250 billion annually in constant 1997 dollars (FY 2000 budget is \$267 billion - nominal). Funds for modernization and other requirements must therefore be created internally - from efficiencies and better business practices - within current top-line budget authority. Thus, the impetus toward outsourcing and reengineering is largely a budget driven process. Adjusted for inflation, Defense spending is 40 percent lower

than in 1985, the peak year. Fiscal reality is such that unless DOD takes the lead to create large-scale internal efficiencies, elected officials will be forced to effect such change by draconian budget cuts. The unfortunate results - as will be shown - are that those cuts usually lead to a reduction in operational forces (tooth), not infrastructure (tail).

The Modernization Challenge

A decade of budget pressures put wedges between readiness, force structure, and modernization. This created an enormous investment challenge for DOD. The 1997 QDR establishes a requirement of \$60 billion in annual modernization funding by FY 2001 in order to support the warfighting capabilities of *Joint Vision 2010*.¹² Procurement funding, however, has hovered around \$40 billion, down by more than 70 percent over the last decade.¹³ Without top-line budget growth, O&P and other business initiatives are largely seen as the only obtainable source of relief from this pressure.

The modernization challenge is exacerbated by the rapidly-depleting force draw-down dividends. Through the post-Cold War force draw-down, parts, supplies, and major end items from deactivating units were redistributed, limiting the layout of additional funds. The benefits of this dividend have ended. The Honorable James Gansler, current Under Secretary of Defense for Acquisition and Technology, states that DOD is in a “death spiral.” He notes that the aging equipment (the average age of aircraft, for instance, now exceeds twenty years) requires increasingly higher repair costs. These higher costs take funding from modernization to fund current readiness, further delaying new equipment, and in turn further increasing repair costs.

¹² Office of the Secretary of Defense. *Quadrennial Defense Review*. Washington, DC: GPO, May 1997, 59.

¹³ Under Secretary of Defense (Acquisition and Technology)(USD (A&T)), HON James Gansler. Remarks presented to the Association of the U.S. Army. 2 September 1998.

To break out of this cycle, Gansler states the “[N]eed for a revolution in business affairs...Actions *now* are essential for our security in the 21st century.”¹⁴ The services must immediately begin to develop and procure new technology to have weapons and equipment delivered on time to meet the goals of Joint Vision 2010 and Force XXI.

The Revolution in Business Affairs

The QDR stresses the importance of leveraging the Revolution in Business Affairs (RBA) that has permeated the commercial sector. Secretary of Defense Cohen stated that, “[W]e will not be able to realize the promise inherent in the Revolution in Military Affairs (RMA), unless we can embrace the Revolution in Business Affairs.”¹⁵

On November 10, 1997, Secretary Cohen implemented the Defense Reform Initiative (DRI) to institute RBA. The DRI is a sweeping program to reform the business and infrastructure entities of DOD. The DRI contains directives (DRIDs) in four major areas. As shown, commercial sourcing is a main tenet:

- Reengineer. Adopt modern business practices to achieve world-class standards of performance.
- Consolidate. Streamline organizations to remove redundancy and maximize synergy.
- Compete. Apply market mechanisms and competition to improve quality, reduce costs, and respond to customer needs.
- Eliminate. Reduce excess support structures and free resources to focus on core competencies.

¹⁴ USD (A&T), Gansler, 2 September 1998 AUSA Speech.

Overall, Secretary Cohen expects to achieve \$11 billion in annual savings from DRI initiatives by 2005.¹⁶ The DRI directs that all services evaluate their entire military and civilian workforce by 1999 to identify which functions are commercial in nature and can be outsourced or privatized.¹⁷ After their review, the services announced a bold plan, stating that the positions shown in Figure 4 will compete against the private sector between 1999 and 2005.¹⁸ To further promote commercial sourcing, Secretary Cohen also directed in a February 26, 1996 memorandum that all Services make commercial sourcing a priority, and outline their efforts in their Program Objective Memorandum (POM).

Figure 4

<u>Service</u>	<u># Positions</u>	<u>Estimated Savings</u>
Army	73,000	\$3 Billion
Air Force	31,400	\$2 Billion
Navy	64,000	\$2.6 Billion

The Opportunity: DOD Infrastructure - Ripe for Reform

¹⁵ 1997 QDR, 67.

¹⁶ Secretary of Defense, HON William Cohen. Press conference at the Pentagon. 1 March 1999.

¹⁷ Cohen, William, Secretary of Defense. *Annual Report to the President and the Congress, 1998*. Washington DC GPO, 1998, 174.

¹⁸ Calink, George. "Air Force to Compete 31,000 Jobs." *Federal Times*. 1 March 1999, 4.

DOD has the world's largest support infrastructure. Facilities comprise 40,000 square miles - roughly the size of Virginia. Physical plant is estimated at \$500 billion in value.¹⁹ Currently, 55 percent of the DOD budget is allocated to support functions with the remaining 45 percent to combat functions.²⁰ The latest Quadrennial Defense Review (QDR) reports that 61 percent of DOD employees were performing infrastructure functions. Outsourcing some of these support (tail) functions can free funding and management focus for use on the "teeth" and modernization programs.

Since the end of the Cold War, DOD has absorbed 80 percent of all government cutbacks. These reductions resulted in the elimination of approximately 355,000 civilian, and 743,000 military personnel; a downsizing unprecedented since the end of World War II. Unfortunately, the conduct of the downsizing did not result in right-sizing. While defense force structure and budget were reduced by approximately a third from their height, infrastructure was only reduced about 18 percent, creating a "tooth-to-tail" ratio imbalance.²¹

Proponents of commercial sourcing have widely divergent views on the potential savings. The Defense Science Board states that \$30 billion could be saved annually - an amount which would fund the entire \$20 billion modernization shortfall. Other analysts hold much lower estimates. Dr. Loren Thompson from the Alexis de Tocqueville Institute, outlines the rough arithmetic of outsourcing, providing at least an estimate of potential gains:²² 1) Depending on

¹⁹ Cohen, William, Secretary of Defense. *Annual Report to the President and the Congress, 1998*. Washington DC: GPO, 1998, 173.

²⁰ Wilson, George C. "Task force calls for a revolution in thinking." *Army Times*, 10 February 1997, 1.

²¹ Muczyk, Jan. "Generating Needed Modernization Funds: Streamlining Bureaucracy - not Outsourcing and Privatizing - is the Best Solution." *Acquisition Quarterly*. Summer 1998, 321.

²² Thompson, Loren, Dr. "Defense Outsourcing: The Coming Revolution." *Sea Power*. February 1997, 33.

how defined, defense infrastructure consumes \$120-160 billion annually, 2) Private sector examples show world-class companies cut costs 10-30 percent by outsourcing non-core support functions, 3) As DOD has not achieved a world-class level of efficiency, its savings should be at least an average 20 percent, 4) If 20 percent savings could be achieved in even half the DOD infrastructure functions, total annual savings would be \$12-16 billion. Recognizing DOD faces unique limitations and constraints not encountered in the private sector, the conservative estimate above should allow for many of these challenges.

Section IV: Review of Applicable Theory

Political, Social, and Economic Theory

Like private business, DOD may pursue varied goals through commercial sourcing. First, however, it should be noted that it is fundamentally a political process as much as a financial or economic one. On a political level, O&P is advocated as a method to reduce the government's role in the economy, and to allow the competitive market mechanism to exercise without government interference. This philosophy is often referred to as de-nationalism, or de-evolution. The 1960 Bureau of the Budget Bulletin includes the following statement:

“The Government should not compete with its citizens. The competitive enterprise system, characterized by freedom and initiative is the primary source of national economic strength. In recognition of this principle, it has been and will continue to be the general policy of the Government to rely on commercial sources to supply the products and services the Government needs.”

This statement's intent was further codified by Congress as 10 USC 2462 on 19 July 1988, and the 1996 Defense Authorization Act. It is also manifested in numerous limitations and restraints imposed by legislative and regulatory sources (later discussed).

Government interference in the economy also counters Monetarist economic theory (also termed Neo-Classical). This theory states that the closer the market moves to perfect competition, the more efficient it becomes - thus reaching equilibrium of supply and demand - also known as "clearing". This equilibrium solution is thought to result in the most socially desirable outcomes. Monetarists view government economic intervention as a disruption, preventing efficient clearing by altering supply and demand functions. They would state, for instance, that Congress interferes with the market mechanism by providing "corporate welfare" to defense contractors at a sum of some \$10 billion a year.²³ Many advocates also support outsourcing to "level the playing field" by ending what are perceived as subsidized monopolies provided to government-owned enterprises.

Outsourcing also results in a certain loss of internal government sovereignty which must be recognized. As private sector entities take over more public functions, government managers increasingly lose control of the activity's performance. Some critics state that if O&P is taken too far, it could result in a "democratic deficit," taking control of government away from elected officials. Additionally, as forms of private financing are pursued in some partnering initiatives, Congress loses a portion of its power of the purse. If consolidation in the defense sector continues, the military may be faced with doing business with large, powerful oligopolies whose private bureaucracies would be no better than public ones. Of note, these are some of the same arguments which originally led to "big government" in the mid-20th century.

Managerial and Financial Theory

A review of select managerial and financial theories provides a framework for the analysis of DOD commercial sourcing efforts.

The competitive market function is well-proven to create an environment of continuous process improvement, quality improvement, and price reductions. DOD, somewhat shielded from this competition, and protected by a virtual monopoly, has not been driven by this process's incentives. The government has been provided revenues regardless of its performance. Private firms, in contrast, are driven by the constant threat of Economic Darwinism. As discussed, the government's monopolistic protection has eroded due to budget reductions and demands to reduce bureaucracy and increase efficiency. Studies have shown that even when the DOD in-house organization wins the competitive sourcing analysis, that the competitive process itself creates the incentive for qualitative and quantitative improvement. The Army, for example, reduced costs an average of 20 percent through MEO development.²⁴

Much of the reengineering in the private sector has advanced under the theory of core competencies. IBM, for instance, outsourced its manufacturing of computers so it could focus on its competencies of design and marketing. Chrysler outsourced two-thirds of its automobile content to focus on engines, transmissions, and body skins. One of the greatest lessons is that outsourcing should not be undertaken only to cut costs. Japanese firms proved the benefits of

²³ Isaacs, John. "Waste in Pentagon budget." National Commission for Economic Conversion study. 26 Sept 1996, 1.

²⁴ Army Material Command (AMC) Briefing Packet Subject: Privatization within the Department of Defense. 22 May 1996, 5.

using strategic outsourcing to focus on core competencies, and leverage management (allowing them to focus on “A” tasks), thus making their organizations more nimble and flexible.

Complementary to the theory of core capabilities is specialization, drawing from Adam Smith’s theory of “division of labor and specialization of task.” As an organization reduces its scope of missions, it is able to maximize efficiency by creating a focused mix of capital and labor to provide specific products or services. A specialized organization will theoretically draw more volume as its efficiency lowers prices and increases quality. It is then able to make prudent investments in further-advanced specialized equipment, production systems and other assets; it can also invest more robustly in specialized training. If DOD-internal demand (and thus volume) for a product or service is not sufficient to justify resource specialization, DOD can access better efficiency by outsourcing or privatizing a function. For instance, DOD outsourced its entire delivery system for medical supplies to a private distribution company. The company’s world-class capabilities allowed DOD to reduce its inventories by 60 percent - \$380 million - since 1992.²⁵ DOD can also gain access to processes and technology it can’t economically create or maintain in-house. Through specialization and the marginal cost effects of volume, contractors can often provide higher quality services and goods at a lower price.

Inherent in specialization is economy of scale and scope. All organizations have an optimum level of output given the capabilities of their capital and labor mix. Output below this optimum point results in excess, wasted capacity, resulting in higher unit costs. Output exceeding the optimum point results in diseconomy of scale as both capital and labor are overburdened, management span of control is exceeded, and other phenomenon create

²⁵ Muczyk, 321.

inefficiencies. If the government activity (or its demand) is either too large or too small to capitalize on the most effective scale and/or scope, these benefits can often be obtained through outsourcing. A recent GAO report found, for example, that, 1) DOD's capacity for rotary wing aircraft training is twice that needed by the services, and 2) DODs laboratory infrastructure has 35 percent excess capacity.

All effective organizations must also conduct value chain and Total Cost Economics (TCE) analysis. All activities have a value chain of tasks which leads to the production and delivery of a product or service. Management must continuously monitor this chain and eliminate or reduce those activities/organizations which add little or no value to the overall process. All systems, procedures and technology must "buy" its way into the organization by reducing the cost of doing business. If an activity is found deficient and cannot be reengineered, commercial sourcing should be considered. TCE theory states that transactions between providers and users of goods and services along the value chain should be organized to maximize overall value net of all costs. An effective manager will develop the blend of in-house and commercial sourcing which minimizes TCE of each of their value chains.

The leveraging of management is another key benefit of commercial sourcing for the military. An organization can grow too large, the missions too varied, and the span of control too diverse. O&P of non-core functions can focus our leaders' attention on war-fighting and readiness issues. It can be argued that many DOD and Army functions have become so large that they experience the aforementioned diseconomies of scale. These large entities may exceed optimum management span of control. The economist, Coase, presented a theory that organizational constraints caused by layers of bureaucracy, complexity, and span of control will

limit an organization to the same extent that technology and other factors can.²⁶ This theory supports the concept of “bounded rationality;” that individuals cannot possibly know everything that is needed to be known, nor resolve all problems that demand resolution. Bounded rationality is further amplified by distortions created by the bureaucratic process and its inefficient information flow. Organizations simply cannot effectively manage an unlimited number of transactions internally.

Section V: DOD’s Sourcing Goals, Experiences and Process Management

DOD Commercial Sourcing Goals

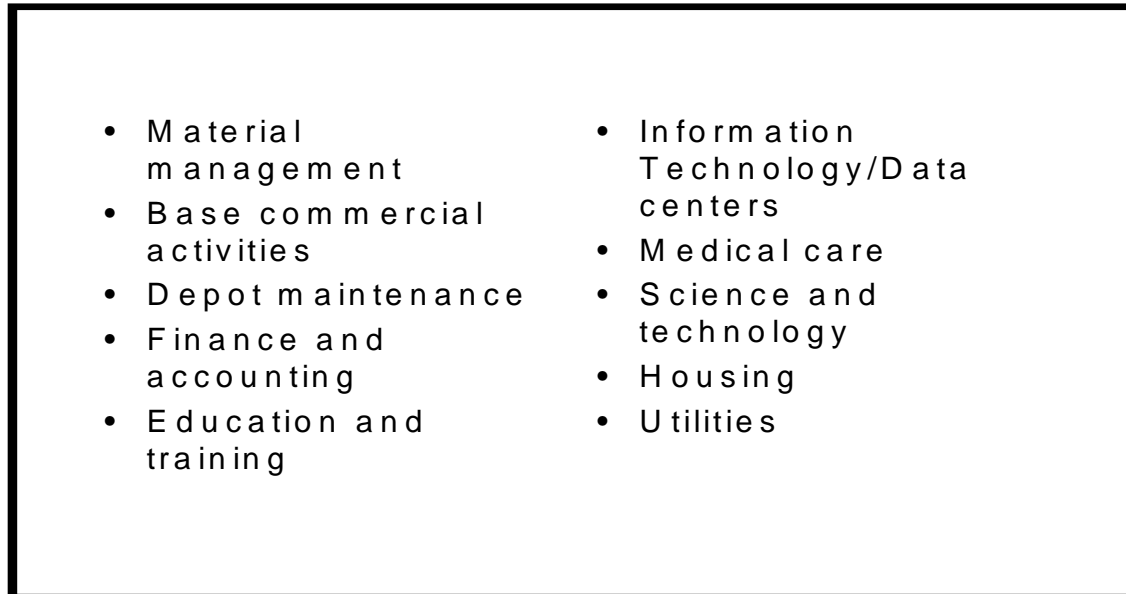
DOD has three primary goals from its outsourcing initiatives: 1) Generate savings for modernization, 2) Sustain readiness in the face of decreasing resources, and 3) Improve quality, processes and efficiency. DOD policy states that activities should be competed if; 1) In-house performance is not required to meet mission requirements, 2) a competitive market exists for the activity, and 3) competition results in the best value for the government.²⁷ DOD is currently focusing its outsourcing initiatives in ten key areas shown in Figure 5.²⁸

²⁶ Prager, Jonas. “Contracting out government services: lessons from the private sector.” *Public Administration Review*, March/April 1994, 179.

²⁷ Kaminski, Paul, Dr. Under Secretary of Defense for Acquisition and Technology. Remarks presented to the Association of the Industrial College of the Armed Forces. 24 April 1997, 4.

²⁸ DOD Privatization Integrated Policy Team, December 1995.

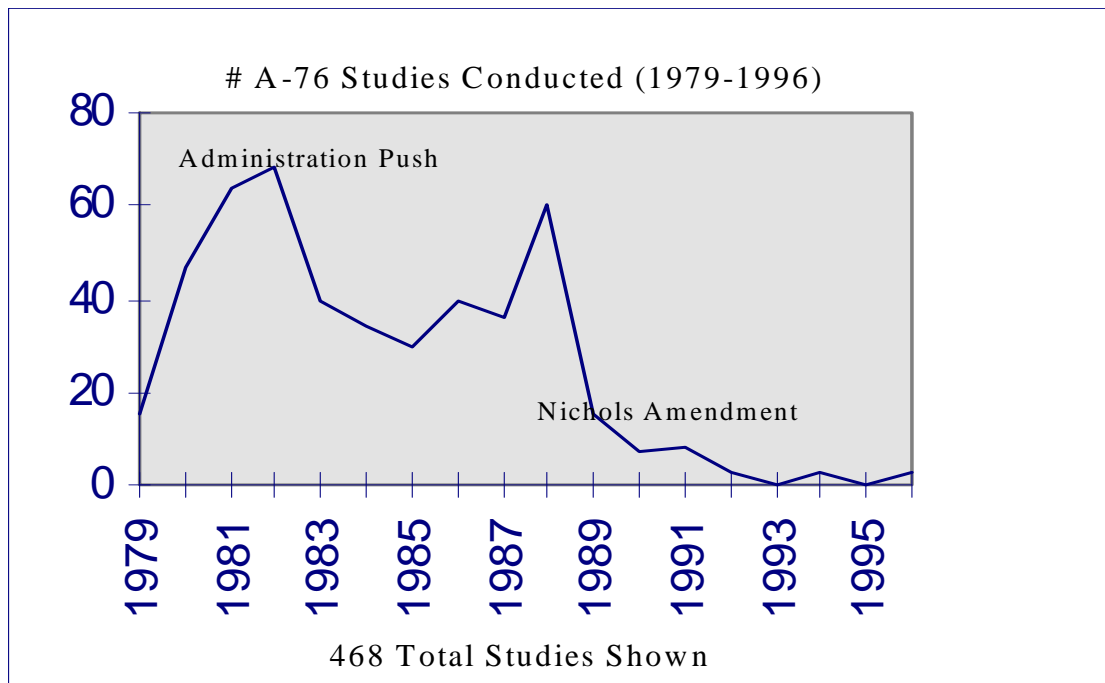
Figure 5



DOD Experiences and Successes with Commercial Sourcing

DOD commercial sourcing has been extremely cyclic. Political pressures, resistance by employee unions, and adverse incentives basically ended competitions after 1991. In 1992, Congress passed the Nichols Amendment, placing a moratorium on further O&P studies. Chart 2 below shows, as an example, the effects of this amendment on Army studies. The moratorium was recently lifted, but the services have yet to resume notable efforts. From 1995 to 1998, DOD conducted a mere 53 A-76 reviews, covering 5,757 FTEs.

Chart 2 (From Department of the Army Data)



Many completed DOD outsourcing initiatives have been successful. Results from A-76 competitions conducted between 1978-1994 show 31 percent average annual savings as shown in Figure 6 below, from the November 1996 Defense Science Board report. Approximately 51 percent of the competitions were won by contractors. Out of these studies, over 50 percent were for installation support activities.

Consolidations to capitalize on economy of scale, such as the consolidation of 320 Defense Accounting Offices from the Defense Finance Accounting Service (DFAS) into 21 Operating Locations (OPLOCS) has been extremely successful. Similar success has been achieved by the Defense Information Systems Agency (DISA), where they are in the process of

outsourcing 57 percent of their operating budget, allowing them to consolidate from 59 data centers to 16 megacenters, and reduce personnel by 2400 Full Time Employees (FTEs).²⁹

Figure 6

	Competitions Completed	Average Annual Savings (in \$M)	Percent Savings
Army	510	470	27%
Air Force	733	560	36%
Marine Corps	39	23	34%
Navy	806	411	30%
Defense Agencies	50	13	28%
Total	2138	1478	31%

The Defense Logistics Agency (DLA) also had great success with its medical supply direct delivery program. Costs were cut by 25-35 percent, inventories were reduced by 61 percent, and response times improved by 75-90 percent.³⁰

DOD is also utilizing O&P to free up military manpower. As force structure is limited by Congress, DOD can free military members from infrastructure and support roles by transferring their function to the private sector. Military manpower can then be transferred to the operating forces. The Army, for example, recently began a test program of outsourcing ROTC instructors on selected college campuses, using separated or retired military members as contractors.

²⁹ DOD Privatization Integrated Policy Team, March 1996, 11.

³⁰ DOD Privatization Integrated Policy Team, May 1996.

Paradigms are being broken by the successes gained in contractor logistics support (CLS) of contingency operations. The Secretary of Defense issued DOD directive DD5000.2 which requires the use of CLS where able. These contracts are estimated to have saved DOD \$110 million in Somalia, \$6 million in Rwanda, \$141 million in Haiti, \$5 million in Southwest Asia, and \$6 million in Italy. In Bosnia, the contract cost was \$100 million compared to an estimated \$318 million it would have cost to have soldiers do the work.³¹ These programs have shown that outsourcing can be used to support deployed contingency operations with acceptable risk.

DOD's Competitive Sourcing Process Management and Organization

DOD and most services do not have a central proponent responsible for competitive sourcing. The lack of central authority creates redundancy, prevents synergy and results in uncoordinated efforts.

DOD and each Service should create a central office to oversee competitive sourcing and act as a support office for their commercial activities undergoing competitive studies. Authority is diffused, with each domain controlling competitive sourcing in their respective area of influence. In the Army, for instance, the Assistant Chief of Staff for Installation Management has proponency for initiatives concerning base operations and other installation activities. The Assistant Secretary of the Army for Installations and Logistics has proponency for depots and CLS. With lack of an effective full-service support office, commanders often turn to private contractors to conduct their analysis and competition studies. Military outsourcing has become

³¹ Brower, Michael. "DOD Outsourcing and Privatization." *Military Review*. September-November 1998, 64.

an industry in itself. Private consulting firms specializing in the conduct of competitive sourcing analysis and A-76 studies for the government have been created. The GSA schedule has a plethora of these consultants listed.

To achieve synergy and meet the goals of the RBA, the Service offices must have the authority and active support of their Service Secretary so that they maintain sufficient power among the various Secretariats and staffs to discharge their mission. They will otherwise become ignored players as many TQM/reengineering offices are today. The office must be free from parochial incentives, so placement of the office is critical. It could work under the Office of the Secretary itself, but would run the risk of being labeled an elitist organization. Perhaps a better model would be placement within the Resource Management (RM) field. The Services' Assistant Secretaries for Financial Management have little proponency for executing programs - only for their resourcing. Thus, they have the best chance of being an honest broker. The RM field also has a large population of personnel trained in both financial analysis and business practices. The teams, however, must be cross-functional, with subject matter experts in many fields: human resources, legal, environmental, contracting, accounting, engineering, etc. Each service office should provide the following functions:

- * Champion the process. The office should ensure there is a service-wide strategic sourcing plan. They should ensure that all installations and activities aggressively pursue lucrative initiatives, and look for service-wide or regional commercial sourcing opportunities to capitalize on economy of scale.

* Promulgate service-wide policy to facilitate commercial sourcing. The office should also be the services' representative to DOD for reform or repeal of restrictive legislation and policy. The office should also ensure consistency across the service. They could conduct objective review and analysis of cost studies and outsourcing competitions to deter dysfunctional behavior. They could also conduct business reviews to analyze the prospective contractor's business practices, solvency, performance history, and ability to meet and sustain the PWS.

* Provide education and training. The office could provide mobile training teams and consultant groups to assist installation commanders and other leaders in the conduct of studies and analysis. The team should provide costing, contracting, MEO, PWS and other comprehensive help. The team should also provide assistance with human resources issues for resulting personnel transitions. These teams would function much like internal consultants in major corporations who advise and monitor progress in their corporation's Small Business Units (SBU). They could conduct courtesy auditing, training, and infuse the latest business technology into organizations as they conduct their process improvement activities and reengineering in attainment of MEO.

* Act as a center for lessons learned and historical knowledge. The office could provide copies of past performance work statements, solicitations, and quality surveillance plans to assist in the quality and speed of future studies. They could also hold training seminars and produce newsletters to display successes.

* Interface between activities and external entities. Service teams would provide a buffer to relieve burdens on their activities, by providing interface with DOD, OMB, Congress and other external entities.

* Provide interface and input to the Planning, Programming, Budget System (PPBS) to gain funding for competitive sourcing studies and initiatives. Service funding of start-up costs, for instance, would provide incentive for installations to aggressively pursue commercial initiatives.

The DOD office would perform much the same roles as the service ones, but would focus on inter-service and joint consolidations and initiatives. They would also interact with Congress, OMB, and other external entities (e.g., labor unions) to relieve the services from negative interference. The DOD office should also champion the Services' commercial sourcing initiative resource needs in the DOD level PPBS cycle.

Section VI: Limiting Factors and Risks of Competitive Sourcing

DOD-Internal Factors Limiting Competitive Sourcing

The most serious impediment to DOD commercial sourcing is bureaucratic inertia. Dysfunctional organizational behavior exists due to incongruent performance and reward systems for financial management and personnel policies. This behavior greatly limits movement toward better business practices and efficiency, and thus skews outsourcing competition, by the failure of some activities to truly reach the MEO.

Investment funding is a major disincentive. Process improvement and commercial sourcing initiatives have start-up investment costs which must be paid for in the current budget year, although efficiency savings will not be realized until the out-years. A-76 studies, for instance, can often cost up to \$6000 per full time employee studied. DOD, however, will only

reimburse the organization up to \$2000. To overcome organizational resistance, and dysfunctional behavior, DOD should fully fund study costs, or allow out-year payments.

As many appropriated funds cannot be transferred between line items, and most unobligated funds not spent by year end are lost, behavior such as “spend it or lose it” is also created. Managers are penalized by creating efficiencies in their organizations. If managers create efficiencies through O&P, they ultimately lose all the savings, as it is common for their budgets to be cut the following year as they demonstrated they can get along with less.

Commercial sourcing is also often seen as a threat to current, entrenched organizations. In a 1996 study, the Center for Naval Analyses concluded that 82 percent of competitions won by commercial suppliers resulted in some job displacement, and only 3 percent of employees were hired by the contractor winning the competition - in spite of rules requiring the right of first refusal to displaced employees. CNA states that this figure was partially due to the ability of 38 percent of the displaced workers to find another civil service job - a chance much lower now since the draw-down.³² This fear of job security, and a general reluctance to change, often spawn dysfunctional behavior and sub-optimization in the sourcing process.

To provide incentives for organizations to create and maintain the MEO, DOD must better align internal performance and reward systems to support desired behavior. Budget responsibility needs to be better aligned with authority. Additional stress should also be placed on resource management in leader’s performance evaluation reports. The military must also readdress DOD civilian pay and personnel policies. It is not enough to expose in-house defense organizations to market forces. To accomplish the RBA, the employees themselves must face

³² Tighe, Carla et. al. *Implementing A-76 Competitions*. Center for Naval Analyses Study. May 1996, 22.

the same competition. Congress must remove DOD-specific employee protection not offered to other federal employees. DOD reviewed a proposal in 1997 and 1998 to move civilian employees from Title 5 civil service laws to Title 10 military personnel laws to simplify hiring, job classification, separation policies, and allow greater flexibility to create performance based pay and benefits systems. This proposal died under strong opposition from federal unions.³³

An alternative to competitive sourcing is the advent of employee owned businesses under an Employee Stock Ownership Plan (ESOP), as encouraged by the Vice President's NPR. An ESOP transfers ownership of a government activity to the employees, who then have a set time to improve the activity prior to them being competed against other private bidders. An ESOP can minimize the negative effects on the employees while helping transition of the activity to the private sector.

Another recommendation is the establishment of a contract-like Memorandum of Agreement (MOA), to hold the in-house organization to the same performance measures as a contractor would. Under current rules, if the in-house organization wins the sourcing competition, it cannot be re-competed for five years. The MOA would provide for measures of continuous levels of performance. The MOA may also provide for incentives such as gain-sharing, which is now allowable under recent regulation.

Another way to increase the healthy effects of market forces is to allow private sector companies to petition the Services to open activities for competition. The process would be similar to the practice of unsolicited proposals used in the acquisition field. Congress - angered by Federal Agency foot-dragging on A-76 studies after they repealed the Nichols amendment - moved toward this end by instituting the Fair Activities Inventory Reform (FAIR). FAIR

³³ Calink, George. "Reorganization—DOD Turns to Private Sector, Seeks Base Closings." *Federal Times*. 4

requires all Federal Agencies to publish lists of all their in-house commercial activities (as previously defined) and the number of full-time employees required to perform them. The only exemption from FAIR is the existing process of declaring a commercial activity as inherently governmental. This new visibility will create pressure from the private sector to hold competitions for these lucrative activities. There is not, however, provision under FAIR to force unsolicited bids as found in acquisition regulations.

External Factors Limiting Competitive Sourcing

Many external impediments to competitive sourcing exist. The most far reaching of these are legislative and regulatory restrictions. Many are arbitrary in nature and limit DOD's flexibility to achieve the RBA, and meet mission requirements in the most efficient manner. For instance, various regulations require the preference of small and/or minority owned businesses in contracting. These rules prevent the bundling of smaller contracts to capitalize on economy of scale and volume discounts. Numerous small contracts also add to oversight costs and thus raise TCE.

To save detailed discussion here, the most critical of the numerous legal and regulatory impediments are outlined in Appendix A, along with the author's summary analysis of their effects on commercial sourcing.

Secretary Cohen articulated the oppressive impact of these restraints in the 1997 QDR:

Many of these opportunities [outsourcing] are restrained by regulations and practices built up during the Cold War. We need to deregulate defense just as we have deregulated other American industries so we can reap the cost and creativity benefits of ... competition. Ultimately, we need to decide what is more important; keeping a maintenance depot in government hands or advanced technology in soldier's hands; protecting a facility, or protecting our forces; preserving local defense contracts, or promoting solid enlistment contracts.

The Depot CORE concept (as outlined in Appendix B) is faced with limitations greater than any other activity. CORE depot activities are those organic capabilities (facilities, equipment, and personnel) required to ensure we preserve the in-house warfighting readiness and mobilization structure required to support the National Military Strategy and contingency scenarios.³⁴ This concept, however, is sub-optimized by legislation, such as the 60/40 laws. These laws prevent the outsourcing of no more than 40 percent of depot work, regardless of CORE requirements. Previous Deputy Secretary of Defense John P. White stated in a DOD press release, "Such restrictions prevent DOD from taking full advantage of private sector opportunities and are counter to good government and managerial principles."³⁵ The same press release states, "There is no analytical basis for the current 60 percent floor at military depots." Other impediments, as outlined in Appendix A, have prevented the depots from even reaching 40 percent. As of 1996, 31 percent of Army, 38 percent of Navy, and 35 percent of Air Force depot work was contracted. Approximately two thirds of the \$13 billion of depot maintenance is currently conducted by 89,000 DOD employees, with the remaining third outsourced to some

³⁴ DOD Privatization Integrated Policy Team, March 1996, 10.

³⁵ Office of the Secretary of Defense, Press Release. *DOD reports to Congress that the Military can sharpen it's combat edge through outsourcing.* 4 April, 1996, 2.

1200 private companies.³⁶ There is no immediate reprieve from these restrictions as the “Depot Caucus” in Congress again struck down DOD’s latest request for lifting the 60/40 cap.

DOD is additionally limited by Congress’ resistance to further Base Closure and Realignment (BRAC) rounds. Additional BRAC authorization would facilitate increased commercial sourcing. The Secretary of Defense stated in a March 1, 1999, press briefing that, “Our greatest need right now is for Congressional approval of two additional [BRAC] rounds in the year 2001 and 2005 which would save us an additional \$3 billion a year.”³⁷ It is unlikely that further base closings will be approved in the 2000 election year, but DOD might succeed in gaining this authority for 2001 or 2003.

Risks Inherent in Commercial Sourcing

There are various risks associated with commercial sourcing that DOD managers should address. First, O&P inherently results in a loss of flexibility. Once let, most contract costs essentially become fixed costs. Regulatory requirements to modify and /or cancel a contract can provide less flexibility than the original organization. DOD should seek partnerships and other more flexible relationships to diminish this risk.

Additionally, as outsourcing increases, funding may shift among appropriations. Depending on the nature of these shifts, and any associated regulatory guidance - such as from the Appropriation Act - DOD may face additional rigidity and “fencing” of funds beyond that currently experienced.

³⁶ Under Secretary of Defense (Logistics) Briefing Packet to Chief of Staff of the Army. *Outsourcing Departmental Workload and the CORE Concept*. 27 March 1996, 10, 17.

³⁷ Secretary of Defense, HON William Cohen. Press conference at the Pentagon. 1 March 1999.

DOD must also fully assess the military's captivation by these contracts, and the danger of union strikes and other similar pressures. The Air Force, for example, outsourced essential elements of its pilot training program at Shepard AFB, and was devastated by a contractor strike which brought training to a halt. Once private sector businesses gain public functions, (possibly through contract low-balling) and the government dismembers its organic capability, the contractor is afforded a position of great influence - and if not otherwise deterred - cost-creep may result. With the aforementioned consolidation in the defense sector, DOD may begin to deal more with large oligopolistic corporations who can exert increasing influence.

O&P also increases DOD's exposure to market risks, such as price fluctuations, and unavailability of goods and services. These risks must be weighed against potential impacts.

Oversight should also be analyzed. As more government functions are outsourced to various regional contractors, greater State and Congressional constituent interest will likely develop. This increased involvement could result in political pressures and restrictions as seen today with the Depot Caucus.

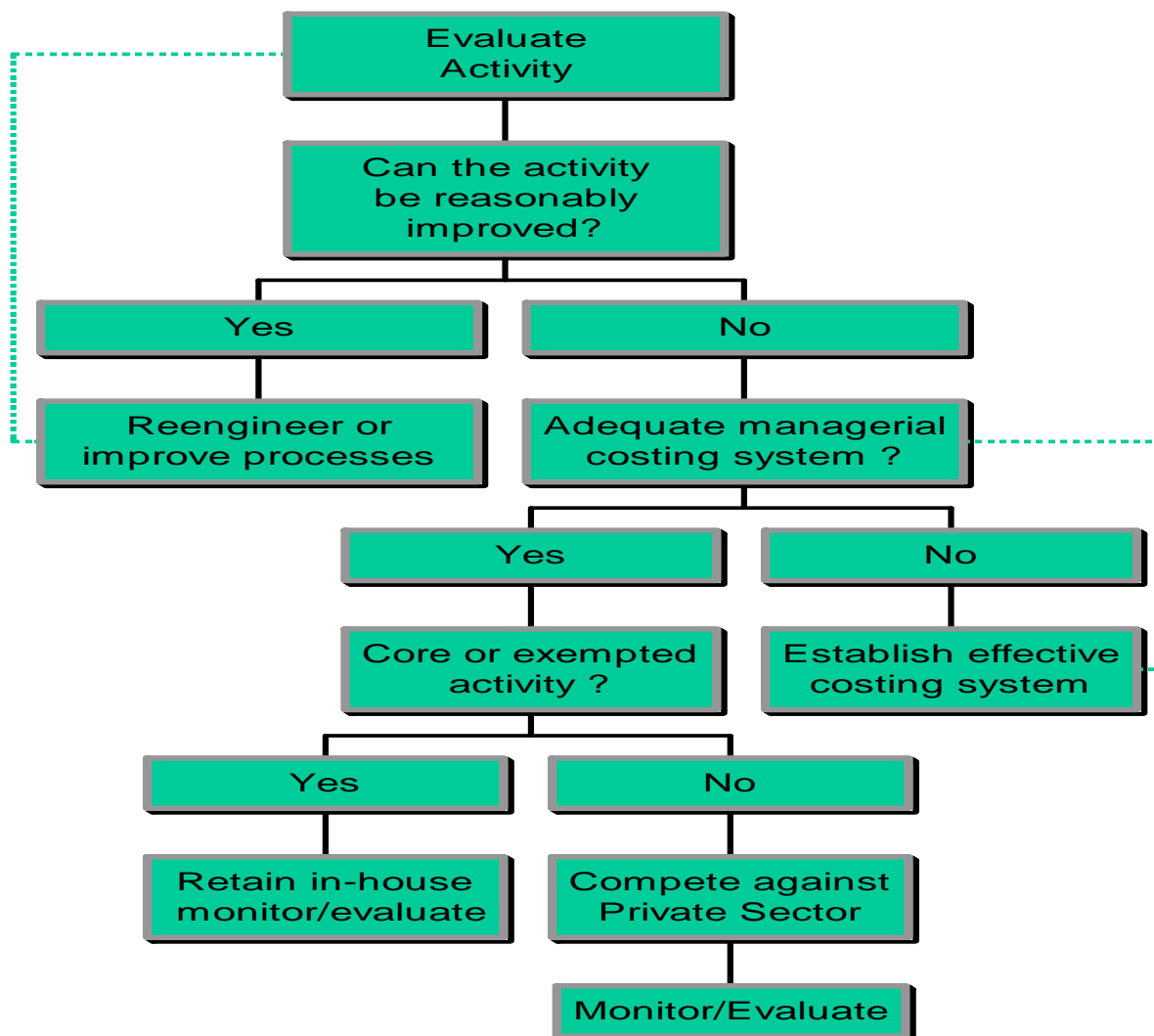
Section VII: Final Recommendations and Thoughts

RBA as an Enabler to Effective Competitive Sourcing

As shown, O&P can be a great tool when prudently leveraged. DOD must, however, carefully analyze the execution of its outsourcing initiatives. DOD has yet to institute the radical reengineering and process/quality improvements accomplished in the private sector in the '80s and early '90s. It should, therefore, not be misled by the private sector's pace in implementing O&P efforts in the 1990s - from their more efficient state. Competitive sourcing is not only a tenet of RBA, but the two are codependent. The term Most Effective Organization (MEO) is now a misnomer. DOD managers must be given the flexibility, incentives, and tools provided to their private sector counterparts to enable them to create state of the art organizations as envisioned in the RBA. Only then can truly competitive analysis occur. DOD managers are in the predicament of a Civil War era surgeon. Without the tools and knowledge to save the limb, they are forced to remove it (outsource and privatize) to save the patient. Perhaps some organizations are so infected with inefficiency and bureaucratic malaise that they cannot be saved, but most can be improved with proper leadership, incentives and resources. After the RBA is institutionalized, DOD can begin to intelligently analyze outsourcing as a tool. Figure 7 below offers a recommended commercial sourcing thought process.

Figure 7

Outsourcing Decision Model



Arguably, the most critical area requiring RBA reform is DOD accounting systems. Major accounting systems are not compatible, fail to provide managerial costing information, and don't allow cross-functional analysis. DOD has initiated reengineering in this area, but there is a long way to go. From 1991 to 1998, DOD reduced its major accounting systems from 127 to 34, with a goal to ultimately reduce that number to 9.³⁸ Proponents report savings (or potential

³⁸ Cohen, William, Secretary of Defense. *Annual Report to the President and the Congress, 1998*. Washington DC: GPO, 1998, 156.

savings) gained from outsourcing, yet these are based on inaccurate costing data. DOD, for instance, does not yet have systems to accurately value assets such as real property and inventories.

Current systems fail to analyze opportunity costs and the cross-functional, TCE impacts of O&P decisions. Transaction costs such as environmental compliance costs, costs of contracting and monitoring vendor compliance, increased audit costs, increased costs to the disbursing and payment offices, and program and project management costs are not definable under current systems. If outsourcing volume increases significantly, these costs can assume a step function on the cost curve and become very large. For example, the Defense Contract Audit Agency (DCAA) was inundated with a huge backlog of almost 13,000 audits, totaling \$160 billion (3-5 years worth of work) as of September 30, 1991.³⁹ Current costing systems fail to attribute the cost of such increased workload to the correct causal cost driver (the increased contract load).

The 1993 Government Performance and Results Act (GPRA) mandated that all agencies establish performance-based budgeting in order to link resources to results. This needed change will hopefully force DOD to alter accounting systems from mere control functions to planning and managerial functions.

When DOD cannot yet create auditable financial statements as mandated under the Chief Financial Officers (CFO) Act, it cannot rely on accounting data to conduct competition studies. This is not to say competitive sourcing should wholesale be postponed until all accounting systems are improved. Managers must, however, ensure they extrapolate past the data provided

³⁹ Prager, 11.

by the current systems, and understand that they may have a large margin of error in their studies.

Strategic Partnering - a Solution?

Once proper analysis is complete - and a Service makes the decision to commercially source an activity – defense/industry partnering should be considered. Long term partnerships between buyers and suppliers can improve performance and lower costs, particularly for complex products. Each partner can focus on core competencies and specialization to maximize the performance of their assigned tasks in the value chain.

To create this relationship of horizontal integration, DOD must create interdependent strategic alliances which share information, risk, and reward. The suppliers must have the incentives and confidence to invest in transaction-specific assets and human resources. DOD cannot continue to treat its suppliers as arms-length vendors, and maintain practices like “termination for convenience of the government” clauses. Through risk sharing and interdependence, effective systems can be established to deter dysfunctional behavior. These partnerships must maintain market-like incentives to promote continuous improvement and maximize value net of costs.

O&P contracts must, therefore, be performance based. Currently used performance measures, such as purchase price or machine utilization, can be problematic. Some examples of more effective performance measures for utilization in contracts are shown in figure 8.

Figure 8

Performance Based Measures

- Response Time
- System Availability
- Downtime
- Turnaround Time
- Schedule of Performance
- Nonperformance Penalties
- Price Adjusted IAW Periodic Industry Benchmarking
- Profit sharing and cost incentives

Partnering can provide great benefits to DOD. One of the most lucrative benefits could be the access to capital. Housing is a prime example. In a March 9, 1999, testimony to the House Armed Services Committee, the acting Deputy Under Secretary of Defense (Installations) stated, “Approximately two-thirds of DODs nearly 300,000 housing units need extensive renovation or replacement. Fixing this problem using only traditional military construction [MILCON] would take 30 years and cost as much as \$16 billion dollars.”⁴⁰

Through partnering, private funding can be gained to construct the housing units, and private firms can greatly accelerate construction cycles. The contractors will then be provided stable, long-term lease agreements.

Congress has slowly given DOD tools to affect partnerships. The 1996 and 1997 Defense Authorization Acts allowed DOD, for the first time, to sell or out-lease excess land.

⁴⁰ Under Secretary of Defense (Installations), (acting) Randall Yim. Testimony presented to Congress. 9 March 1999.

These asset redevelopment initiatives maximize the use of installations and are lucrative to both parties. Some ongoing initiatives include the joint use of airfields and railroad facilities.

One of the most important decisions a manager can make in competitive sourcing initiatives is the packaging of the work. How/which functions are grouped together for a competition will determine the level of involvement and interest from potential bidders, the savings realized from the competition, and the quality and reliability of the service after award. As much as is allowable under current restrictions, DOD must categorize and bundle its PWSs to effect lucrative vendor interest and competition.

The legal and regulatory guidance in the area of private funding is, however, very lacking. There are implications, as previously discussed, for a degradation of Congress' power of the purse. DOD guidance must be promulgated in this area to support these initiatives.

A final issue may be fairness. Long-term partnership alliances may be perceived as unfair to competitors, and regulatory and legal restrictions may dissuade these relationships.

Section VIII: Conclusion

Budgetary pressures have created a crisis for DOD. It is unable to meet demands for modernization, housing, and other needs. Additionally, political pressure has mandated more efficiency within DOD, and competition with the private sector. Commercial sourcing can be an effective enabler to meet these forces. Foremost, it can be used to leverage management, reduce costs, and increase quality. Before DOD travels too far toward that end, however, it must spend more effort accomplishing the RBA. Initiatives should be sponsored to reengineer current

organizations and processes with forceful intent. Simultaneously, a proper performance-based managerial costing system must be created. When complete, effective managerial decisions can be made in the analysis of commercial sourcing. Along with the RBA, DOD needs to review its internal performance and reward systems and align these systems to support desired organizational behavior. Many systems now promote dysfunctional behavior which prevents attainment of the RBA and commercial sourcing goals. Additionally, regulatory and legal impediments exist which limit DOD managers' ability to choose the most appropriate mix of in-house and outsourced activities. Relief from these limitations needs to be continually addressed by the DOD leadership. In the meantime, creative solutions within these bounds, to include partnering initiatives, should be pursued to create the most effective outcomes. To orchestrate this effort and ensure strategic goal synergy, management organizations should be improved. DOD and each service should establish a single office with the authority and resources to affect and facilitate commercial sourcing.

Appendix A: Legal Impediments

There are many legal and statutory impediments to outsourcing. This appendix will outline the most far reaching of these, along with an analysis of their impact.

1. Cost comparison restrictions:

- 10 USC 2461. Places DOD-unique detailed requirements for formal cost studies before outsourcing a function with more than 45 employees. This statute doesn't apply to other federal agencies and imposes administrative burden and time lag.
- 10 USC 2465. Prohibits contracting out security guards and firefighters. This statute creates a severe burden on small facilities, and on bases in the process of downsizing or closure, who must maintain expensive activities.
- 10 USC 2467. Places DOD-unique, detailed requirements for inclusion of retirement system costs of both DOD and the contractor in cost comparisons. This limits the government's competitiveness.
- Section 8015 of the FY97 Appropriations Act. Further restricts the A-76 and 10 USC 2461 requirements for cost studies of functions with 45 employees by placing DOD-unique requirements for "informal" cost comparisons of functions with 10 to 45 employees.

2. Wage rate restrictions:

- 42 USC 276 (Davis-Beacon Act). Establishes artificially high wage rates (prevailing rate as specified by the Department of Labor) that must be paid by government contractors in all federal construction, alteration, and repair contracts over \$2000. This inflates contract costs and

interferes with the market mechanism. This statute and 41 USC 276 below artificially skew A-76 competitions in favor of the in-house workforce.

- 41 USC 351 (Service Contract Act). Further expanded Davis-Beacon to include all federal service contracts over \$2500.

3. **“Anti-Bundling” restrictions:** These rules limit the ability to capitalize on economy of scale in outsourcing, by limiting the consolidation of requirements under large contracts. These rules require preference in contracting to certain groups and business types. These rules also restrict the market mechanism function. The FY 96 Authorization Act did, however, allow for a facility-wide pilot program on two installations for comprehensive base contracting. Results are pending.

- 15 USC 631(Small Business Act) Gives preference to small businesses.
- 41 USC 252 (Federal Property and Administrative Services Act) Reinforces 15 USC 631, and includes preferences for economically and socially disadvantaged individuals.

- Office of Federal Procurement Policy Letter (1991) and reinforced in the Federal Acquisition Regulation (FAR). Specifies targets of contract “set-asides” of 20 percent of all contracts to small businesses, 5 percent to minority owned, and 5 percent to woman owned businesses.

- 20 USC 107 (Randolph-Sheppard Act). Gives absolute preference to blind vendors.
- Congress Initiative (1994) Established a Government wide initiative to set aside contracts for small businesses as above, or give a 10 percent price evaluation preference in competitions.

4. Civil Service restrictions: These rules affect outsourcing by limiting the tools available to the military to reshape the civilian workforce.

- DOD-unique employee “extra rights” not afforded to other federal employees. An example is the FY93 DOD Authorization Act, which doubled the 60 day period requirement between notice and separation to 120 days for DOD employees.

- Another restriction is Title 5, which prevents focused Reductions in Force (RIFs), (the separation of employees in a specific job series and grade) by providing bump-and-run rights. Title 5 also prohibits involuntary transfers to fill new or vacant positions at an installation through non-competitive fills.

5. Fiscal restrictions:

- Section 8065 of the FY96 Annual Appropriation Act. Sets the limit of transfers to OPA from OMA accounts under investment criteria to 100K.

- 31 USC 3302 (Miscellaneous Receipts Act) Greatly restricts what “earned money” produced by local activities can be used for, and otherwise requires transfer to the general Treasury. This Act limits the services ability to capitalize on best business practices.

- 31 USC 1353 (Economy Act). Prevents DOD from combining contracts with those of state and local governments. Consolidation could often allow for great benefits for both parties, and increase community interaction.

6. Real property/Environmental restrictions: The real estate restrictions limit privatization by limiting flexibility in the transfer of government property. The environmental restrictions place bureaucratic and lengthy requirements in outsourcing that contractors do not require to complete in private sector contracts.

- 42 USC 11411 (McKinney Act) Limits privatization by requiring notice to GSA of all excess property for possible use by the homeless.

- 40 USC, Chapter 10. Limits privatization by preventing the transfer of any installation real property, fixtures, or equipment without Congressional action; regardless of amount or value of the item.

- 42 UCS 4331 (NEPA) Requires burdensome environmental studies and documentation prior to outsourcing regardless of the number of employees.

- 42 USC 7661 (Clean Air Act). Requires burdensome clean air conformity determinations prior to outsourcing.

7. Other targeted restrictions:

- Public Law 102-392. Prohibits commercial contracting of printing services. DOD Dir. 5330.3 further requires all printing to go through the Defense Printing Service.

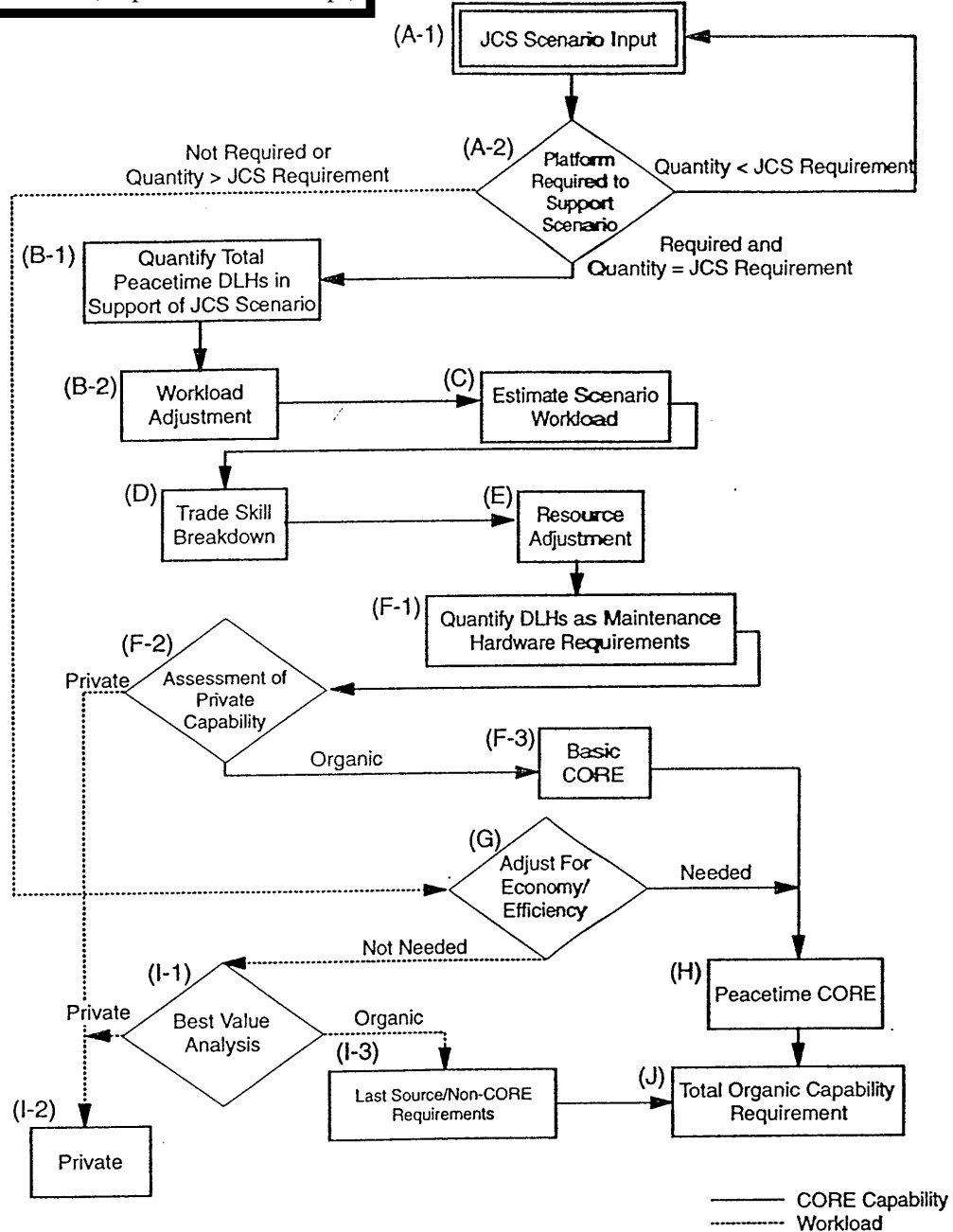
- Title 10, Sec. 2466 and 2469 (60/40 rule). As previously discussed, arbitrarily limits outsourcing of depot work to no more than 40 percent, regardless of in-house requirements under the CORE concept.

- Title 10, Sec. 114. Prohibits contracting out of Research and Development (R&D) functions under A-76 circular.

- Title 10, Sec. 4532 & 9532. Requires mandatory use of in-house DOD factories and arsenals, regardless of inefficiencies, or cost competitiveness.

- Sec. 317, FY87 Authorization Act. Arbitrarily prohibits any contracting out at McAlester or Crane Army Ammunition Plants.

Appendix B (Depot CORE Concept)



CORE Methodology

Appendix C (Summary of the A-76 procedures)

A summary of the formal A-76 procedure follows:

- 1) Conduct a Commercial Activity Proposed Action Summary (CPAS), and identify a cost comparison study team.
- 2) Notify Congress. Notification is required before study initiation if the activity in question has more than 45 civilian employees. Otherwise Congress must be notified prior to actual conversion.
- 3) Notify workforce/ freeze the organization.
- 4) Create a Performance Work Statement (PWS)/ Statement of Work (SOW) developed by the study team. Specifies the tasks, workload, and levels of service required and the availability of government assets (if any) in execution of the tasks.
- 5) Establish a Quality Assurance Surveillance Plan (QASP) to oversee the competition process and post-award performance reviews.
- 6) Conduct a management study to define and develop the in-house Most Efficient Organization (MEO). This process analyzes and reengineers the existing organization and operation to identify improvements and reduce resources used to perform the PWS. The MEO forms the basis of the in-house cost in the cost comparison. As previously mentioned, the MEO process itself has resulted in a 20 percent cost reduction even when the activity was kept in-house.

7) Cost estimates for in-house performance by the MEO are then developed and reviewed. Indirect costs are also calculated which will be incurred in conversion; such as oversight and contracting costs, and other items such as employee separation costs.

8) Bids or proposals are then solicited from private industry in accordance with the Federal Acquisition Regulation (FAR), and the Defense Federal Acquisition Regulation Supplement (DFARS). The PWS will comprise the technical performance sections of the Request for Proposals (RFP) or Invitation for Bid (IFB) issued by the contracting officer. The contract type will also be identified; sealed bidding (based on cost only), or competitive negotiation (includes qualitative factors) commensurate with the activity type and FAR requirements.

9) Conduct of the cost comparison, and announcement of the results to both Congress and locally is completed next. According to the A-76, to be converted, a contractors bid must be at least 10 percent under the government MEO. This margin allows for inaccurate costing and miscellaneous costs not identified in the MEO/PWS, such as temporary loss of productivity, unspecified conversion costs, and opportunity costs. The final cost comparison is conducted on a specific Cost Comparison Form (CCF) as outlined in A-76 and shown at Appendix D.

10) Conduct of overwatch and quality control. As specified in the QASP, if the government wins the competition, a post-MEO performance review is required. If the in-house activity is shown to fail in meeting the MEO or PWS requirements, the contracting officer will award the contract to the next lowest bidder in the competition. Quality control per the QASP is also conducted if a commercial contract wins the competition, with similar procedures.

CONDITIONS PERMITTING GOVERNMENT PERFORMANCE OF COMMERCIAL ACTIVITIES

1. *National Defense or Intelligence Security.* The Secretary of Defense, or designee, approves national defense justifications. The Director of Central Intelligence, or designee, approves national security justifications.

2. *Patient Care.* Commercial activities at Government-owned hospitals or other health facilities may be performed by in-house, ISSA or contract employees when needed to maintain the quality of direct patient care.

3. *Core Capability*;. A core capability, of in-house and contract resources may be warranted for certain functional areas.

4. *Research and Development.* Research and development activities may be converted to or from in-house, contract or ISSA without cost comparison. Severable support activities are subject to the cost comparison provisions of this Supplement.

5. *No Satisfactory Commercial Source Available.* Agencies will solicit private sector interest and certify that the solicitation did not restrict or otherwise limit competition.

6. *Functions With 10 or Fewer FTE.* May be converted to or from in-house, contract or ISSA, without a cost comparison, if the contracting officer determines that reasonable prices cannot otherwise be obtained.

7. *Meet Performance Standard.* Agencies may demonstrate that the activity meets or exceeds generally recognized industry cost and performance standards, after all adjustments required by this Supplement.

8. *Lower Cost.* Results of a cost comparison demonstrate that in-house performance is less costly.

9. *Temporary Authorization.* Temporary emergency performance may be warranted not to exceed the next full contract option year.

CONDITIONS PERMITTING CONTRACT PERFORMANCE OF COMMERCIAL ACTIVITIES

1. *Contracted Activities.* Should be obtained by contract, unless a cost comparison demonstrates that in-house or ISSA performance is more cost effective.

2. *New Requirement.* Should be obtained by contract, unless contract quality or price appear unreasonable. A cost comparison is performed to convert the activity to in-house or ISSA performance.

3. *Severable Expansions.* Same as above.

4. *ISSAs.* Commercial activities should not be performed through new or expanded ISSAs, except as provided by law or this Supplement.

5. *Activities With 10 or Fewer FTE.* May be converted to or from in-house, contract or ISSA, without a cost comparison.

6. *Activities with 11 or More FTE.* May be converted to contract or ISSA, without cost comparison, if fair and reasonable contract prices can be obtained by competitive award and all

directly affected Federal employees on permanent appointments can be reassigned to other comparable Federal positions.

7. *Activities Performed by the Military.* Activities performed by military (uniformed) personnel may be converted to contract without cost comparison. Military positions included in cost comparisons are cost at the composite rates provided by the DOD or other appropriate agency Comptroller.

8. *Preferential Procurement Programs.* Contract performance may be granted, without cost comparison, if the contract is awarded to a preferential procurement program.

9. *Lower Cost.* Conversion to contract is required if a cost comparison indicates that contract performance is the lower cost alternative.

Appendix E (A-76 Standardized Cost Comparison Form)

IN-HOUSE PERFORMANCE	PERFORMANCE PERIODS					Total
	1st	2d	3d	Add'l		
1. Personnel						
2. Material and Supply						
3. Other Specifically Attributable						
4. Overhead						
5. Additional						
6. Total in-house						
CONTRACT OR ISSA PERFORMANCE						
7. Contract/ISSA Price						
8. Contract Administration						
9. Additional						
10. One-Time Conversion						
11. Gain on Assets	()	()	()	()	()	
12. Federal Income Taxes	()	()	()	()	()	
13. Total Contract or ISSA						
DECISION						
14. Minimum Conversion Differential						
15. Adjusted Total Cost of In-house Performance						
16. Adjusted Total Cost of Contract/ISSA Performance						
17. Decision Line 16 minus 15						
18. Cost Comparison Decision: Accomplish Work						
In-House (+)						
Contract or ISSA (-)						

Appendix F (A-76 Streamlined Cost Comparison Form)

		PERFORMANCE PERIODS				
IN-HOUSE PERFORMANCE		1st	2d	3d	Add'l	Total
1. Personnel						
2. Material						
3. Overhead						
4. Other						
5. Total in-house						
CONTRACT OR ISSA PERFORMANCE						
6. Contract/ISSA Price						
7. Contract Administration						
8. Federal Income Taxes	()	()	()	()	()	()
9. Total Contract or ISSA	()	()	()	()	()	()
DECISION						
10. Minimum Conversion Differential						_____
11. Adjusted Total Cost of In-house Performance						_____
12. Adjusted Total Cost of Contract/ISSA Performance						_____
13. Cost Comparison Line 12 minus 11						_____
14. Cost Comparison Decision: Accomplish Work						_____
In-House (+)						_____
Contract or ISSA (-)						_____

Annotated Bibliography

Army Material Command (AMC) Briefing Packet Subject: Privatization within the Department of Defense. 22 May 1996.

This item is an Army-internal briefing presented on 22 May, 1996. The briefing provides an overview and status of ongoing Army and DOD outsourcing and privatization efforts. The briefing provides good data for analysis and comparison in this study. It also addresses the pressures on the Federal Budget due to increasing entitlements (social security etc.) and the need for DOD to create efficiencies to meet this challenge.

Brower, Michael. "DOD Outsourcing and Privatization." *Military Review*. September-November 1998, 64.

Mr. Brower discusses the huge share of all federal budget cuts that DOD was forced to bare over the last decade. He discusses the impacts of these cuts on the DOD workforce. This article is beneficial to this study only for background budgetary data.

Calink, George. "Reorganization—DOD Turns to Private Sector, Seeks Base Closings." *Federal Times*. 4 January 1999, 10.

This article addresses challenges to outsourcing and privatization (O&P) due to the inability of DOD to gain Congressional support for base closings. It also discusses needed civilian personnel reform to free DOD to implement its reform initiatives. This source aids this studies analysis of impediments to O&P.

Calink, George. "Air Force to Compete 31,000 Jobs." *Federal Times*. 1 March 1999, 4.

This short article outlines DOD positions that will be competed for outsourcing between 1999 and 2005. It is useful to this study only for background data.

Cohen, William, Secretary of Defense. *Annual Report to the President and the Congress, 1998*. Washington DC: GPO, 1998.

The DOD annual report is required under Title 10 and the 1986 Defense Reorganization Act. It outlines the security environment, strategy implications, and priorities of DOD. It also portrays the status of services and DOD agencies, ongoing and planned initiatives, and other status briefings. This particular report outlines and

summarizes DOD initiatives on reengineering, reform, O&P, and other business reforms which are essential to this study.

Commander, U.S. Army Forces Command. Memorandum to the Chief of Staff of the Army (CSA). Subject: "Legislative Changes to Facilitate Privatization." 20 March 1996.

This memorandum to the CSA outlines the challenges faced by the Commander of Forces Command (one of the Army's Major Commands, and the largest owner of Army bases) in his efforts to outsource and privatize. The memorandum lays out the various legislative impediments faced by all DOD services, and outlines their negative effects. The memorandum provides good reference for this study on factors limiting DOD outsourcing and privatization efforts.

Chairman of the Joint Chiefs of Staff, General Shaliskashvili. Testimony before the Senate Committee on Armed Services. Washington, DC, 5 March 1996.

In this speech to the Armed Services Committee, the Chairman of the Joint Chiefs of Staff discusses the challenges of DOD in meeting its modernization requirements within available funding. He discusses leveraging outsourcing and privatization and other business opportunities as tools to meet this challenge. His remarks add to this study's factors moving DOD toward O&P.

Code of Federal Regulations, *Federal Acquisition Regulation (FAR)*.

The FAR establishes uniform policies and procedures for the procurement of supplies and services by the Federal government. The Defense Federal Acquisition Regulation (DFAR) is a subset of the FAR and applicable specifically to DOD. Once the decision to outsource an activity is made, the FAR/DFAR regulate procedures for vendor competition and selection, contract types, contract audit and oversight, and all other vendor interface. The FAR/DFAR are further articulated in DOD and service regulations. This source reference will be reviewed throughout this study.

Deputy Secretary of Defense, Memorandum to Services. Subject: *Privatization and Outsourcing*. 2 February, 1996.

This memorandum provided guidance to the Service Secretaries on the conduct of privatization and outsourcing. Of import to this study, the memo changed existing policy to allow the Services to maintain cost savings and reprogram them to modernization programs - a key change for the services.

DiTrapani, Anthony R. *Rightsourcing Lessons Learned*. Center for Naval Analysis Study. May 1997.

This study was contracted by the Navy to CNA Corp. to study commercial sourcing in both the private and public sector, and provide lessons learned. The study does an excellent job outlining reasons for outsourcing, criteria for the decision making process, contracting issues, and common mistakes among other topics.

Goodman, Glenn W. "Cueing the QDR." *Armed Forces Journal*, February 1997, 12.

This defense journal article discusses the 1997 Quadrennial Defense Review and assesses its impacts on DOD. The article discusses the budgetary strain on operational forces due to increased operational tempo, and the need to thus streamline infrastructure and support bureaucracy. This article provides good discussion on factors pushing DOD toward O&P.

Gore, Albert, Vice President, United States of America. Remarks to the "Global Forum on Reinventing Government." Washington DC. 14 January 1999.

In his remarks, the Vice President discusses the necessity to privatize to obtain his goal of reinventing government. His remarks are to an international audience and are thus mostly inapplicable to this study. He does, however, speak to the administrations ongoing efforts to reform civil service reform legislation. This initiative is key to create most-efficient government organizations for outsourcing competition.

Isaacs, John. "Waste in Pentagon budget." National Commission for Economic Conversion study. 26 Sept 1996.

This article discusses waste and inefficiencies in the DOD budget. It briefly discusses contracting and outsourcing and will be used for study background information.

Kaminski, Paul, Dr. Under Secretary of Defense for Acquisition and Technology. Remarks presented to the Association of the Industrial College of the Armed Forces. 24 April 1997.

In this speech, Dr. Kaminski provides his thoughts on DOD business practices to the student body of the Industrial College. Pertinent to this study, he provides insight on the criteria for choosing to outsourcing a DOD activity.

Muczyk, Jan. "Generating Needed Modernization Funds: Streamlining Bureaucracy - not Outsourcing and Privatizing - is the Best Solution." *Acquisition Quarterly*. Summer 1998. 317.

This article takes a contrary view to contemporary opinion and is very critical of outsourcing. The article states that DOD is better to streamline and reengineer current processes versus sourcing its activities. The article well outlines organizational theory such as Parkinsons Law, Specialization, Bounded Rationality, and other challenges to overcome bureaucratic grid-lock. This source was useful in developing factors limiting reform and reengineering.

Office of Management and Budget, Circular No. A-76. *Performance of Commercial Activities*. Washington DC: GPO, March 1996.

The A-76 Circular contains the official OMB regulatory guidance to all Federal Executive Departments for the conduct of studies and analysis for commercial activities. It regulates which activities are to be competed, the methods to be used, and the criteria for decision. As the primary regulatory document, this circular will provide invaluable reference throughout this study.

Office of the Secretary of Defense, Press Release. *DOD reports to Congress that the Military can sharpen it's combat edge through outsourcing*. 4 April, 1996.

This official DOD press release outlines the benefits to be gained by DOD through outsourcing non-inherently military functions. Central to the releases message, is that outsourcing can create savings which can free funding for weapons modernization and other deficient programs. This item provides background information for this study and further impetus to outsource.

Office of the Secretary of Defense. *Quadrennial Defense Review*. Washington, DC: GPO, May 1997).

This item is the final report from the Secretary of Defense's quadrennial comprehensive review of the military, as required under the Military Force Structure Review Act. The QDR analyzed all combat, support, and infrastructure organizations; it resulted in guidance to the Service Secretaries on force structure, modernization, business practices (to include O&P), and other areas. This inclusive review provides abundant data for use throughout this study.

Office of the Under Secretary of Defense (Acquisition and Technology). Defense Science Board Task Force Report. *Outsourcing and Privatization*. Washington DC: GPO, August 1996.

The Defense Science Board (DSB) is a panel of civilian and military subject matter experts called together by the Secretary of Defense, and given charter to analyze contemporary DOD programs and issues. The August 1996 DSB panel was asked to analyze outsourcing and privatization within DOD. The November 1996 DSB panel (bibliography entry below) expanded upon this study and looked at all DOD infrastructure (installations, base activities, depots etc.) to provide recommendations for better business practices. The later study posited that \$30 billion could be saved through outsourcing. The reports provide good comparison of private sector initiatives. Although arguably unfeasible, the reports also provide numerous recommendations for DOD O&P initiatives for analysis in this study.

Office of the Under Secretary of Defense (Acquisition and Technology). Defense Science Board Task Force Report. *Achieving an Innovative Support Structure for 21st Century Military Superiority*. Washington DC: GPO, November 1996.

Outsourcing and Privatization Team, U.S. Army. Outsourcing status briefing packet. 18 May 1997.

This is an internal Army briefing packet from an O&P in-progress review. It shows the status of planned and ongoing initiatives, and reviews guidance from senior Army and DOD leadership. The briefing provides background data.

Prager, Jonas. "Contracting out government services: lessons from the private sector." *Public Administration Review*, March/April 1994, 176-184.

This article analyzes outsourcing trends in the private sector, and translates applicable lessons learned to public sector O&P initiatives. The article provides good comparative data for this study.

Privatization Integrated Policy Team, Office of the Deputy Secretary of Defense. (IPT) Progress Status Briefing Packet. 1 December 1995.

This is an internal DOD briefing from the IPT team. It provides in-progress review, applicable to this study, on planned and ongoing DOD O&P efforts.

Privatization Integrated Policy Team, Office of the Deputy Secretary of Defense, Information Paper. *Improving the Combat Edge Through Outsourcing*. March 1996.

This item is an internal DOD informational reference from the IPT team. It is an extremely comprehensive paper, and was one of the most applicable sources to this study. The paper analyzes the benefits and goals through O&P, and provides examples of successful implementation. It also discusses methods and summarizes guidance for the sourcing of commercial activities. This source will be used throughout the study.

RAND Corporation. *Strategic Sourcing: Theory and Evidence from Economics and Business Management*. RAND Corporation. Santa Monica, CA. 1997.

This excellent reference is a study contracted by the Air Force to the RAND Corporation to analyze economic and financial management theories of outsourcing, and how the Air Force can utilize these theories in their analysis of sourcing commercial activities. This is one of the few references on theory (specific to DOD) that the author could locate.

Roos, John G. "The Outsourcing Boom." *Armed Forces Journal*, October 1996, 18-20.

This defense journal article discusses the proliferation of outsourcing initiatives within DOD. It provides examples and analysis of ongoing initiatives applicable to this study. Of particular import, this is one of the few references which analyzes contractor support of contingency operations.

Roos, John G. Interview with General Riemer, Chief of Staff of the Army (CSA). "Forging a full spectrum force." *Armed Forces Journal*. October 1996, 30.

In this interview, General Riemer discusses his vision for the full-spectrum force of the future under Force XXI. Applicable to this study, he speaks to the leveraging of O&P and private sector initiatives to support funding for his vision. He also addresses the successes of utilizing contractors for contingency operations.

Secretary of Defense, HON William Cohen. Press conference at the Pentagon. 1 March 1999.

In this press conference the Secretary discusses DOD's progress on the Defense Reform Initiative (DRI) and its outlook for further implementation. In this briefing, he announces \$11 billion of planned annual savings from the DRI. Additionally he

discusses the need for further BRAC rounds to gain an additional \$3 billion in savings. Useful for study background.

Secretary of Defense, HON William Perry. Information release to Congress. 4 March 1996.

In this congressional testimony, Secretary Perry outlines the criticality of O&P to gain savings which can be reprogrammed for use in under-funded modernization programs.

Thompson, Loren, Dr. "Defense Outsourcing: The Coming Revolution." *Sea Power*. February 1997, 31-34.

This article is by Dr. Loren Thompson, the Director of the Alexis de Tocqueville Institute, and a consultant to the Defense Science Board. He discusses the benefits and complications of DOD outsourcing. The article provides a short but useful macro analysis of the benefits of outsourcing, estimated cost savings, private sector experience, and challenges to implementation. His comments will benefit analysis of O&P initiatives.

Tighe, Carla et. al. *Implementing A-76 Competitions*. Center for Naval Analysis Study. May 1996.

This study was part of a series contracted by the Navy to CNA to evaluate lessons learned and practices in the conduct of A-76 studies for commercial sourcing. The study addresses the A-76 process very well and provides an honest critique of its shortcomings. It also provides good recommendations for process improvements.

Under Secretary of Defense (Acquisition and Technology), HON James Gansler. Remarks presented to the Association of the U.S. Army. 2 September 1998.

In his remarks, the HON Mr. Gansler discusses the DOD modernization crisis. He outlines the 70% drop in modernization funding over the last decade, and the increasing maintenance costs and requirements on DOD's aging equipment. Pertinent to this study, he discusses the imperative need for O&P and other business reforms and initiatives.

Under Secretary of Defense (Logistics) Briefing Packet to Chief of Staff of the Army.
Outsourcing Departmental Workload and the CORE Concept. 27 March 1996.

This briefing focuses on the status and challenges of O&P efforts at DOD depots and supply centers. The brief discusses regulatory and other codified restraints preventing DOD O&P implementation. It also outlines the CORE capabilities concept for discussion in this study.

Under Secretary of Defense (Installations), (acting) Randall Yim. Testimony presented to Congress. 9 March 1999.

In this testimony to the Military Installations and Facilities Subcommittee of the House Armed Services Committee, Hon Mr. Yim outlines DOD's goals and efforts to privatize military housing and utilities. He also discusses the status of Defense Reform Initiative Directives (DRID), and progress made on the 1996 Military Housing Privatization Initiative.

United States Code (USC).

The United States Code holds a plethora of laws for the conduct of government contracting, sourcing, and commercial activities. It also codifies social goals, such as the provisions for award to small and minority owned businesses. Applicable laws will be referenced throughout this study.

Vice President of the United States, Albert Gore. *National Performance Review*. Washington DC: GPO 1997.

The NPR directs the reengineering and streamlining of government bureaucracies and their processes. It further directs that all Federal Agencies eliminate bureaucratic restraints and lessen regulatory impediments. It sponsors delegation and promotes DOD and other agencies more authority to pursue better business practices. The tenets of the NPR are further articulated in DOD and service regulations. As many NPR initiatives refer to O&P, their review is pertinent to this study.

Washington, William. "Subcontracting as a Solution, not a Problem in Outsourcing."
Acquisition Review Quarterly. Winter 1999.

This article discusses the contracting process. Beneficial to this study, It provides good recommends and processes for choosing contractor performance criteria, comparability measures and other metrics. The article also talks of the pros and cons of prime versus subcontracting.

White, John P., Deputy Secretary of Defense. Lecture to the Maxwell School of Citizenship. "Adapting to New World Realities." 18 April 1996.

In this lecture, the HON John White outlines challenges and opportunities in the post-Cold War environment. He discusses the budget effects of the force draw-down, and relates those effects to force modernization goals. He discusses the pressures on the DOD budget to create efficiencies, such as O&P. These remarks will assist in building context for this study.

Wilson, George C. "Task force calls for a revolution in thinking." *Army Times*, 10 February 1997.

This article discusses the findings of the 1997 Defense Science Board (DSB) report, as discussed earlier in this bibliography. It analyzes the validity of the DSB's findings, and the feasibility of the proposed recommendations within the Army. The article discusses the benefits of pursuing selected O&P programs. This article provides a useful alternative viewpoint to the DSB study. The article also outlines the large allocation of the DOD budget to support infrastructure activities.